A Peek Down the Road Not Travelled:
Ontario Court Rules in Favour of Devonshire Trust

Two weeks ago, the Ontario Superior Court ruled in favour of Devonshire and therefore its investors and against Barclays Bank PLC, who was found, most significantly, to have made fraudulent misrepresentations to Devonshire and acted improperly in attempting to terminate its assets. Depending on the outcome of pending litigation surrounding the Devonshire liquidity agreement, it is increasingly likely that the Devonshire investors will receive close to 100% principal repayment.

Devonshire Trust was one of the third party ABCP conduits that 'froze' on August 13, 2007. It was part of the Montreal Accord restructuring process until December 2007, when Barclays Bank, its sole asset provider, decided to exit from that process and proceed independently by negotiating directly with Devonshire's largest noteholder, the Caisse de Depots et Placements de Quebec (CDPQ). That process ultimately broke down and found its way to the courts.

Since Devonshire was removed from the broad restructuring that gave rise to the MAV notes, this result does not directly affect MAV noteholders. However, the 135 page ruling presents a fascinating view of the maneuvering and machinations that led to the eventual termination of Devonshire's assets. It might also be the closest that we will get to an answer to the great 'what if' of the ABCP crisis: *what if the Investor Committee chose or was forced to seek legal recourse rather than a negotiated settlement?*

What happened.

Devonshire was one of the last third party conduits to enter the market. It was launched in the second half of 2006 and its underlying assets consisted of two leveraged super senior swaps totaling $600 million. Barclays was the swap counterparty (asset provider) and, as was the custom in these deals, Barclays was also the liquidity provider for the conduit's liquidity backed notes.

When the ABCP market seized in 2007, Devonshire sent market disruption notices to Barclays on August 13, 14, and 15 requesting that funds be provided to repay the maturing ABCP on those days. Barclays did not provide the liquidity funding and Devonshire responded on the 14^{th} with a default notice, which Barclays was allowed three days to cure.

Because of the broad Standstill Agreement reached under the Montreal Accord, Devonshire agreed on August 16^{th} to suspend the default notice without prejudice and to not attempt to enforce its rights under the default until the expiration of the Standstill Agreement. Even though Devonshire was removed from the Montreal

Accord restructuring process, this suspension notice was extended three times until April of 2008, after which it was re-issued on a daily basis until January 12, 2009. The purpose of the standstill agreement was to allow, initially, the Pan-Canadian Investor Committee to negotiate amongst the parties and then later to allow Barclays and CDPQ to attempt to negotiate a separate settlement of Devonshire trust.

In April 2008, a hand-shake deal was reached in New York between the former head of CDPQ, Henri-Paul Rousseau and the co-CEO of Barclays Capital, Jerry del Missier, that laid out a framework for resolving the issues and dealing with the other 'small investors'.

In the fall of 2008 and as credit markets deteriorated to historic lows, CDPQ wanted to amend the terms of the settlement to be more in-line with that being reached by the Pan-Canadian Investors Committee. Barclays continued to negotiate with CDP and made some concessions from the April position.

At the beginning of January 2009, negotiations appeared to reach an impasse, especially regarding CDPQ's proposed moratorium period on collateral calls and the amount of additional collateral Barclays requested CDPQ to post.

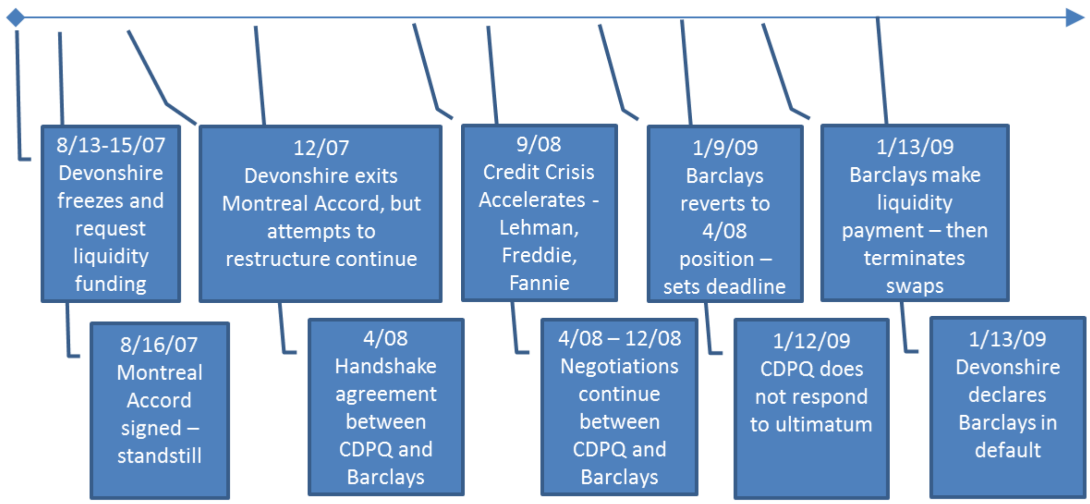
On January 8, 2009, Barclays sent a term sheet that was based on the terms of the April NYC meeting to CDPQ and requested that the board "ratify (their) previous agreement", thus 'undoing' all the negotiations that had occurred between April and January. Barclays set a deadline of January 12 for CDPQ to accept the term sheet.

On January 13, 2009 at 9:04 a.m., Barclays sent notice to Devonshire Trust that it had made arrangements for payment of the liquidity funding that was demanded on August 13, 14, 15 of 2007. Barclays took the position that this cured their default on the Liquidity Agreement.

Four minutes later, Barclays began sending Devonshire Trust notices of early termination, essentially claiming that Devonshire was insolvent as it hadn't been able to roll paper – and thereby honour its liabilities – since August 16, 2007.

Devonshire countered at 2:22 p.m. that afternoon with its own notice of termination, alleging that Barclays' failure to pay on the liquidity lines on August 13, 14, 15 was an event of default.

The chart below graphically outlines a timeline of some of the key events.



The Ruling.

The court's analysis is that Barclays' "*plan of attack*" on January 13 was to cure the default due to their failure to fund the liquidity call and immediately declare a termination event. This would have the effect of triggering a switch under the governing contracts whereby Barclays claim on the assets would precede that of the investors.

The court found that, although Barclays did have a right to cure its default, it did not do so prior to sending its termination. In essence, he found that a 4 minute advanced notice of impending payment prior to issuing a termination notice did not constitute payment.

He further found that Barclays made fraudulent misrepresentations to Devonshire in their suspension notices on and following September 9. Namely, Barclays stated that negotiations with CDPQ were continuing when in fact Barclays had effectively ended the negotiations by issuing its ultimatum, which it knew CDPQ would find unacceptable. These misrepresentations had the effect of ending the bi-lateral standstill agreement between Barclays and Devonshire on September 9.

Last, the court found that Devonshire did have the right to declare an early termination event on September 13, as the cure period for Barclays had ended by September 13 (the three days that 'counted' were August 15, 2007 and September 9 and 10, 2009). The effect of Devonshire's rightful termination is to subordinate Barclay's claim to payments of principal and interest to the Devonshire investors.

If the additional matter surrounding liquidity is dropped or resolved in Devonshire's favour, those investors should receive full repayment of their principal.

The Great 'What If?'

This judgment did not address the matter of whether Barclays was indeed liable to fund its liquidity obligations when Devonshire was unable to roll its paper. This is deliberate: the parties to the legal proceeding requested that this issue be bifurcated and addressed in a separate hearing. It is possible that this hearing will never take place as Barclays' legal strategy focused on its claim that it had cured the default and was within its rights to terminate. By bifurcating the matter, Barclays apparently hoped to avoid litigating a potentially huge and contentious issue in such a public forum.

But the judgment does brush against the liquidity issue. To wit: "*The evidence makes clear, in my opinion, that Barclays never had an intention to pay the liquidity demands made on August 13, 14, and 15, 2007…. It is clear from internal Barclays documents prior to the signing of the contractual documents with Devonshire in the first place that Barclays intended to take the position that there would never be a market disruption event within the meaning of the contractual documents if bank sponsored conduits were rolling…*"

We do not have the benefit of a legal test of this position but we can assert that the standard required by DBRS as rating agency at the time that Devonshire was launched was that if the conduits of more than sponsor were not rolling, a market disruption event has occurred. This requirement has nothing to do with the bank sponsored conduits.

So again the great 'what if' questions of the ABCP crisis remain unanswered:

Would the provisions of the liquidity agreements have been legally enforceable against the banks that refused to fund when called upon? No legal authority has ever opined on this.

Did a "General Market Disruption event" occur on August 13, 2007? Most market participants, and all investors, would suggest it did, but we still lack a legal test.

And could legal action or a credible threat thereof have provided the leverage required for ABCP investors to realize a better or quicker return?

Given the comprehensive legal releases that became part of the Montreal Accord restructuring, it is unlikely that we will ever get definitive answers to these questions. However, the Barclays/Devonshire ruling clearly illustrates that for asset providers in the ABCP meltdown, walking away from the negotiating table would not have been easy or without consequence. And while Devonshire Trust had some attributes that differed from the other affected conduits, the court's strong ruling in its favour should cause those involved in the Montreal Accord restructuring to ask themselves, "What if…"